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¶1. (U) Provided below is Embassy Buenos Aires' Economic and Financial Review covering the period October 22-29, 2009. The unclassified email version of this report includes tables and charts tracking Argentine economic developments. Contact Econ OMS Megan Walton at WaltonM@state.gov to be included on the email distribution list. This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

GOA WORKING TOWARD FORMAL OFFER TO HOLDOUTS

¶2. (SBU) In a press conference on October 22, Minister of Economy Amado Boudou announced that the GoA intends to proceed with a formal offer to reopen the 2005 debt exchange. The Minister said that the GoA will seek 'fresh cash' via a new bond for 10% of the face value of the defaulted debt, and that the offer will be "worse" than the 2005 debt restructuring, which it is legally required to be according to the terms of the original exchange. Boudou stated that characteristics of the new bond are still under study but noted that the GoA is looking to pay a single- digit interest rate. There was no indication of the exact timing for the offer, but the GoA has already initiated some of the steps needed for regulatory approval by SEC, Italian, and German regulators. The approval process can take several weeks or longer.

¶3. (SBU) The Minister indicated that an acceptance rate of 60% of the USD 20 billion debt and USD 10 billion in accumulated interest would be positive, and claimed that the banks involved in the process -- Barclays, Deutsche, and Citibank -- have already secured about 50% participation (or about USD 10 billion of the defaulted debt). While it is not clear that there is any particular threshold that will suffice to enable the GoA to gain access to the international credit markets, the GoA is likely to view a high participation rate as boosting its efforts to normalize its relations with the credit market. Indeed, a 60% participation in the re-opening would imply a 90% participation of the original defaulted debt. On October 24-25, Minister Boudou stated that the GoA could return to international capital markets even before completing the expected offer to the holdouts.

¶4. (SBU) On October 27, the GoA sent to Congress a bill to abrogate the so-called "Bolt Law" (Ley Cerrojo), approved in 2005 as part of the original debt restructuring. The law prevents the GoA from making additional offers to holdouts who did not participate in the 2005 debt restructuring without prior authorization from the Congress. The new bill submitted to Congress does not contain any details about the upcoming offer but states that the financial terms and conditions of any new offer cannot be the same or better than those offered to creditors in the 2005 operation.

¶5. (SBU) On October 28, Minister Boudou explained the details of the law to reopen the exchange to the Lower House Budget and Finance Committee. According to the president of this committee, Deputies would vote on the bill on November 3 at the committee level. A floor vote in the full Lower House would follow on November 4. Afterwards, the bill will go to the Senate for approval. Meanwhile, according to press reports, GoA officials will begin a road show during the week of November 2 to meet investors in the U.S. and several key European cities.

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CAPITAL FLIGHT DECELERATES SHARPLY IN THIRD QUARTER
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¶6. (SBU) Capital flows out of Argentina's financial system (by the non-financial private sector) were USD 3 billion in the third quarter of 2009, according to the BCRA's quarterly foreign exchange report, released on October 27. This compares to outflows of USD 5.8 billion in QIII 2008 and USD 5.5 billion in QII 2009. In its report, the BCRA explains that its stabilization policy along with the improved international financial environment were responsible for the improved situation. Some private analysts argue that the post-election uncertainty and receding fears of a fiscal financing crisis were behind the slowdown in private sector capital outflows. Third quarter capital outflows from the non-financial private sector bring accumulated outflows for the year to date to USD 14.2 billion, compared to USD 16.4 billion in the same period last year.
Other highlights of the Foreign Exchange Balance report include:
-- A surplus of USD 2.1 billion for the current account of the Foreign Exchange Market for the third quarter, and an accumulated surplus of USD13.4 billion for the year (this is the net inflow of FX from all trade transactions, including merchandise, services, and investment income), explained mainly by a trade surplus of USD 3.2

billion;
-- A deficit of USD 2.9 billion for the capital account in QIII, generated by the USD 2.3 billion capital outflow from the non-financial private sector and the USD 2.2 billion in payments (considered an "outflow") by the public sector (GoA and BCRA -- mainly interest and principal payments on the Boden 2012). This outflow was partially compensated for by roughly USD 1.8 billion in inflows. Year-to-date, the capital accounts accumulated a deficit of USD 10.7 billion.
-- BCRA reserves dropped $678 million to $45.3 billion in the third quarter, mainly due to the USD 2.2 billion Boden 2012 payment in August, paid for with Treasury funds deposited at the BCRA. However, this fall in reserves was partially compensated for by net BCRA purchases of USD 850 million during the quarter. The peso depreciated 1.3% to 3.84 ARP/USD in QIII.
Note: the Foreign Exchange Balance (FEB) and the Balance of Payments (BOP) report have a similar format. However, the former reports purchase and sales of foreign currency without considering the residency of the parties, while the latter reports economic transactions focusing on the residency of the intervening parties. Also, the FEB uses a cash basis methodology, while the BOP uses accrual accounting. End Note.

SEPTEMBER PRIMARY SURPLUS DOWN 94% Y-O-Y

¶7. (SBU) The GoA announced October 22 that the September primary fiscal surplus declined 94% y-o-y to ARP 223 million from ARP 3.7 billion and was also much lower than private analysts' estimate of ARP 966 million. The surplus dropped 41% m-o-m, even though August was already very weak, with an 85% y-o-y decline. According to RSH consulting, the September primary surplus would have dropped to a deficit of ARP 594 million if the BCRA had not transferred its earnings of about ARP 817 million to the Treasury.

¶8. (SBU) September's poor performance was the result of weaker-than-expected tax revenues, which increased only 6% y-o-y to ARP 20.7 billion, and higher primary expenditures, which increased 29% y-o-y to ARP 20.5 billion. Taking interest payments into account, the overall fiscal balance for September is a deficit of ARP 2.2 billion. According to the GoA, expenditures were mainly driven by an increase in capital expenditures, both in direct real

investment as well as capital transfers. Year-to-date, the primary surplus stands at ARP 8.7 billion, the result of revenues of ARP 179 billion, which increased only 11% in the first nine months of the year and expenditures of ARP 171 billion, which jumped 30% during the same time period. In a press conference, Minister of Economy Amado Boudou attributed the weak fiscal result to the implementation of a counter-cyclical fiscal policy to alleviate the effects of the global crisis. He identified the objectives of the GoA's fiscal policy as strengthening the domestic market, sustaining private economic activity, increasing infrastructure investment, and transfering funds to the provinces and a variety of social programs.

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SPAIN'S TELEFONICA SA WITHDRAWS ITS ICSID CASE
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¶9. (SBU) Spain's Telefonica SA withdrew its case against Argentina before the International Center for Settlement of Investment Disputes (ICSID), the World Bank's international arbitration tribunal. A Telefonica spokesman said to the press on October 21 that pulling the complaint was "a better strategy for the firm," and that this decision would not rule out appealing to the ICSID on the same issue in the future. Telefonica claimed USD 2.8 billion to compensate for the damages caused by economic policies implemented during the 2001/2002 crisis, which converted all contracts from dollars into pesos, devalued the peso, and froze public utility fees. Telefonica's ICSID case against Argentina was suspended in 2006, when the parties launched negotiations over price adjustments. Earlier this year, Telefonica signed a letter of intent with the GOA offering to make new investments in Argentina in exchange for a commitment to renegotiate prices in the future. The parties reached an agreement on September 24, according to which the GOA committed itself to unfreeze fixed-line fees. Telefonica then decided to terminate the ICSID case.

Industrial production index up 3.1% y-o-y

¶10. (SBU) INDEC announced October 28 that industrial production increased 3.1% y-o-y in September, better than the market's forecast of a 1.3% contraction. According to INDEC, during the first nine

months of the year, industrial production declined 1.3% y-o-y. This figure stands in sharp contrast to private estimates such as that of the FIEL think-tank, which pegs the y-o-y decline in industrial production from January-September at 8.9%. In September, the fastest growing industries were automotive (+14% y-o-y), paper and cardboard (+8% y-o-y), and food (+4% y-o-y), while the oil refining and chemicals, and rubber and plastics sub-indices decreased 8% and 0.5% y-o-y, respectively.

MATINEZ